Supreme Court of the United States

OCTOBER TERM, 1936

IN THE MATTER OF UNITED CIGAR STORES COMPANY OF AMERICA, Debtor.	
CITY BANK FARMERS TRUST COMPANY, assignee of Florence H. Bugbee, Petitioner, AGAINST IRVING TRUST COMPANY, as Trustee of the Estate of the above-named Debtor, *et al.*, Respondents.	No. 260

MOTION FOR LEAVE TO FILE BRIEF AND TO ARGUE AS *AMICI CURIAE*

MAY IT PLEASE THE COURT:

The undersigned, with the consent in writing of all the parties, respectfully move this Honorable Court for leave to file the accompanying brief in this case and be heard on the oral argument as *Amici Curiae* on behalf of Ella May Voigt, Dorothy Voigt, and Edward B. Lucius, as Trustees of the William F. Voigt Trust.

JOHN GERDES,
JOHN GODFREY SAXE,
Amici Curiae.

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OF

UNITED CIGAR STORES COMPANY OF AMERICA,

Debtor.

CITY BANK FARMERS TRUST COMPANY, assignee of Florence H. Bugbee,

Petitioner,

AGAINST

IRVING TRUST COMPANY, as Trustee of the Estate of the above-named Debtor, *et al.*,

Respondents.

BRIEF OF JOHN GERDES AND JOHN GODFREY SAXE, AS *AMICI CURIAE*

Preliminary Statement

The *Amici Curiae* are the attorneys for Ella May Voigt, Dorothy Voigt and Edward B. Lucius, as Trustees of the William F. Voigt Trust. The Voigt Trust has a claim against the estate of the Debtor in the sum of over $200,000. The provability of the Voigt claim depends upon the question of law which is involved in this case.

All further references to facts in this brief will be to the facts of the claim of Petitioner herein and not to the facts of the claim of the Voigt Trust.

The Question

This case presents the question whether in proceedings under Section 77B of the Bankruptcy Act a landlord may prove a claim for injury resulting from the rejection of his lease by the trustee in the bankruptcy proceeding in which the 77B petition was filed, where the lease contained no covenant for damages or indemnity and the applicable state law gave no claim for damages for breach of a covenant to pay rent, and where the landlord terminated the lease by reentry after the rejection and prior to the enactment of Section 77B.

If such a claim is provable, the judgment below is erroneous regardless of the correctness of the decision on the question of New Jersey law, which is also involved in the case.

The Statute

"The term 'creditors' shall include for all purposes of this section and of the reorganization plan, its acceptance and confirmation, all holders of claims of whatever character against the debtor or its property, including claims under executory contracts whether or not such claims would otherwise constitute provable claims under this Act. * * *

"In case an executory contract or unexpired lease of real estate shall be rejected pursuant to direction of the judge given in a proceeding instituted under this section, or shall have been rejected by a trustee or receiver in bankruptcy or receiver in equity in a proceeding pending prior to the institution of a proceeding under this section, any person injured by such rejection shall, for all purposes of this section and of the reorganization plan, its acceptance and confirmation, be deemed to be a creditor. The claim of a landlord for injury resulting from the rejection of an unexpired lease of real estate

or for damages or indemnity under a covenant contained in such lease shall be treated in parity with debts which would be provable under section 63 (a) of this Act, but shall be limited to an amount not to exceed the rent, without acceleration, reserved by said lease for the three years next succeeding the date of surrender of the premises to the landlord or the date of reentry of the landlord, whichever first occurs, whether before or after the filing of the petition, plus unpaid rent accrued up to such date of surrender or reentry: Provided, That the court shall scrutinize the circumstances of an assignment of future rent claims and the amount of the consideration paid for such assignment in determining the amount of damages allowed under this paragraph hereunder." Bankruptcy Act § 77B (b)(10), 11 U. S. C. A. § 207 (b)(10).

"A plan of reorganization [may] (6) may reject contracts of the debtor which are executory in whole or in part, including unexpired leases [***]." Bankruptcy Act § 77B (b)(6), 11 U. S. C. A. § 207 (b)(6).

"[***] the judge [***] (5) may direct the rejection of contracts of the debtor executory in whole or in part; [***]." Bankruptcy Act § 77B (c)(5), 11 U. S. C. A., § 207 (c)(5).

Opinion of the Circuit Court of Appeals

The opinion of the Circuit Court of Appeals in this case is reported in *In re United Cigar Stores Co. of America (City Bank Farmers Trust Co.)*, 83 F. (2d) 209. A more complete statement of the Circuit Court's views on the question involved herein is found in *In re United Cigar Stores Co. of America (Otis)*, 83 F. (2d) 202, at 206, and in *Kuhner* v. *Irving Trust Co.*, 85 F. (2d) 35.

The Circuit Court of Appeals held that a claim is not provable in proceedings under Section 77B for the injury

SUMMARY OF ARGUMENT

POINT I

Section 77B gives a landlord whose lease is rejected a provable claim, limited in amount, even though no claim is given by state law and even though the lease contains no express covenant for damages or indemnity.

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The language of Section 77B is similar to that used in the English Bankruptcy Acts and should be given the same meaning.

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Section 77B eliminates the distinction between the provability of claims under leases and claims under other executory contracts.

POINT IV

The decision of the Court below on the Kuhner claim [*Kuhner* v. *Irving Trust Co.*; 85 F. (2d) 35] is contradictory to its decision on the claim in this case.

POINT V

Surrender or reentry after the rejection of a lease does not deprive the landlord of his right to prove a claim. On the contrary, it is a condition precedent to proof of the injury resulting from the rejection.

POINT VI

Section 77B grants the right to prove a claim where a lease was rejected and terminated prior to the enactment of Section 77B in a bankruptcy proceeding which was still pending when the proceedings under Section 77B were initiated.

POINT VII

The grant of the right to prove a claim for the injury caused by the rejection of a lease in a bankruptcy proceeding pending when Section 77B was enacted is not unconstitutional.

POINT VIII

The interpretation of the Court below makes redundant and of no effect the provisions in Section 77B granting the landlord a claim for the rejection of his lease.

POINT I.

Section 77B gives a landlord whose lease is rejected a provable claim, limited in amount, even though no claim is given by state law and even though the lease contains no express covenant for damages or indemnity.

Section 77B(b)(10) first provides that the term "creditors" shall include "holders of claims of whatever character against the debtor or its property, including claims under executory contracts *whether or not such claims would otherwise constitute provable claims under this Act*" (Italics ours).

This language does not purport to give any claim. It merely makes existing claims "provable" regardless of their provability in ordinary bankruptcy proceedings. Aside from specified exceptions, claims are not provable in ordinary bankruptcy proceedings unless they are in existence when the proceedings are initiated. *Zavelo* v. *Reeves*, 227 U. S. 625. In equity receivership proceedings, on the other hand, claims which are in existence before the expiration of the time fixed for filing claims may be proved even though they were not in existence when the receivership proceedings were initiated. *Wm. Filene's Sons Co.* v. *Weed*, 245 U. S. 597. This language in Section 77B serves to adopt the rule which has prevailed in equity receiverships.

This Court has held that in ordinary bankruptcy proceedings a claim arising out of an express covenant for damages or indemnity is not provable if it comes into existence after the bankruptcy petition is filed. *Manhattan Properties* v. *Irving Trust Co.*, 291 U. S. 320. This decision is *not* applicable to corporate reorganization proceed-

ings under Section 77B. The language quoted above adopts the equity receivership rule instead.

If Section 77B contained no other language dealing with the claims of landlords, the provability of such claims in 77B proceedings, under the language already quoted, would be exactly as held by the Circuit Court of Appeals in this case: a claim arising from the rejection of a lease would be provable by a landlord whenever a claim is given under applicable state law or under an effective covenant for damages or indemnity, regardless of whether the claim arose at or after the initiation of the proceedings.

But Section 77B contains additional language—language which clearly gives the landlord a remedy not previously recognized, even in equity receiverships.

Section 77(b)(10) provides:

> "In case an executory contract or unexpired lease of real estate shall be rejected pursuant to direction of the judge given in a proceeding instituted under this section, or shall have been rejected by a trustee or receiver in bankruptcy or receiver in equity in a proceeding pending prior to the institution of a proceeding under this section, any person injured by such rejection shall, for all purposes of this section and of the reorganization plan, its acceptance and confirmation, be deemed to be a creditor."

This language, supplementing the language previously quoted, defines a *new* remedy. "*Any* person injured by such rejection shall * * * be deemed to be a creditor". There is no language restricting the remedy to claims arising under state law or under leases containing express covenants for damages or indemnity.

That a landlord whose lease has been rejected may have a claim even though his lease contains no covenant for damages or indemnity is specifically recognized by Section 77B. The sentence which follows the sentence which has just been quoted refers to a "claim of a landlord for

injury resulting from the rejection" as well as to a claim "for damages or indemnity under a covenant." Bankruptcy Act § 77B(b)(10).

It is significant to note that in the form in which it originally passed the House of Representatives, H. R. 5884 (73rd Cong., 1st Sess., 77 Cong. Rec. 5009-5013, June 5, 1933), the Bill under which Section 77B was enacted, contained a materially different provision as to claims under rejected leases. The provision originally read as follows:

> "In case any executory contract shall be rejected, the same shall be deemed to have been breached and the holder shall be entitled to file a claim for damages for such breach and such claim may be allowed provided such contract shall not have terminated by forfeiture, reentry, or otherwise."

If the foregoing language had been retained in the statute as the only provision regarding rejected leases, no claim not previously existing would have been recognized. The only effect of such a provision would have been to grant provability to a claim which came into existence after the filing of the petition. The mere statement that a rejection shall operate as a breach is insufficient to give a claim in the case of a lease. The deficiency in the law as it existed prior to June, 1934, was not in its failure to regard the non-payment of rent as a breach of the lease, but in its failure to give a remedy for damages for such breach. If the trustee failed to adopt or perform the lease, rent was not forthcoming and a breach of the lease was effected. But the landlord's only remedy for such a breach, in the absence of an appropriate covenant or state statutory provision, was to bring actions from time to time as the rents became due. Most states had statutes permitting the landlord to oust the tenant from possession in summary proceedings, but practically no statutes gave the landlord a right to repossess the property and recover damages for future rents. It is apparent, therefore, that the provision originally inserted in H. R. 5884 gave no relief to the landlord except that it made a claim provable even though the

claim became effective after the institution of the proceedings.

The language which was finally incorporated into Section 77B is obviously intended to give the landlord a right to prove a claim not previously recognized—the right to prove a claim for the "injury resulting from the rejection" of the lease.

The grant of a provable claim to every landlord sustaining injury by a rejection of his lease was a conscious effort on the part of Congress to correct injustices resulting from the previous failure of the law to give a remedy for the damages sustained.

At the common law, a landlord had no claim for damages, except to the extent to which rent had accrued, for breach of a covenant to pay rent in the absence of a specific covenant for damages or indemnity. In a few states a claim was given by statute. Most states, including New York, had no statute on the subject, and consequently no claim could be proved in bankruptcy except for rent which had accrued at the time of the filing of the petition. Even when the lease contained an effective covenant for damages or indemnity, the claim was not provable in bankruptcy unless it had been in existence when the petition in bankruptcy was filed.

If the landlord had no provable claim, the lease was not discharged by the bankruptcy proceedings and the obligations of the lease survived against the bankrupt tenant. The tenant's trustee in bankruptcy was under no obligation to perform the covenant to pay rent or to perform any other covenant of the lease, unless he adopted the lease.

In the absence of an adoption by the trustee, the landlord had no claim against the estate of the bankrupt and no right to participate with other creditors of the bankrupt in the distribution of the bankrupt's assets. While, technically, the lease survived, it survived, in the case of a corporate tenant, against an entity which had

been deprived of all of its assets and which would no longer continue in business.

If, in the enactment of Section 77B, Congress has not granted a provable claim to a landlord for a lease rejected in proceedings under the Section, greater injustice will result in proceedings under Section 77B than formerly resulted in bankruptcy. Bankruptcy proceedings discharge only *provable* debts. Proceedings under Section 77B discharge *all* debts and liabilities, regardless of their provability. See Bankruptcy Act §77B(g),(h); *Foust* v. *Munson Steamship Lines*, U. S. Sup. Ct., Nov. 9, 1936, not yet reported.

The rent provisions in Section 77B should be liberally construed in order that the intent and purposes of the legislature may be given effect. Section 77B, enacted as part of the Bankruptcy Act of 1898, is clearly a remedial statute in purpose and provision. See Weinstein, *Corporations Amenable to Section 77B* (1935) 83 U. of Pa. L. Rev. 853, 863; Sabel, *The Corporate Reorganizations Act* (1934) 19 Minn. L. Rev. 34, 47. It has frequently been said that federal bankruptcy acts, being remedial in character, are entitled to a liberal construction.

> "It has been aptly said that 'the Bankruptcy Act is remedial and should be interpreted reasonably and according to the fair import of its terms, with a view to effect its objects and to promote justice' (Botts *v.* Hammond, 99 Fed. 916, 920, 40 C. C. A. 179 [C. C. A. 4]); and, in working out these ends, the bankruptcy courts have not indulged in technicalities wherever a liberal procedure was consistent with the substantial rights of the parties in interest; * * *"
>
> *Emerson* v. *Castor*, 236 Fed. 29, 34.

> "The national bankruptcy act establishes a uniform system, and regulates, in all their details, the relations, rights, and duties of debtor and creditor. It should be interpreted reasonably and according to a

fair import of its terms, with a view to effect its objects and to promote justice. Black, Bankr. 274; *In re* Muller, Fed. Cas. No. 9, 912; Silverman's Case, Fed. Cas. No. 12,855."

Blake, Moffitt & Towne v. *Francis-Valentine Co.*, 89 Fed. 691, 693.

POINT II

The language of Section 77B is similar to that used in the English Bankruptcy Acts and should be given the same meaning.

The phrase "any person injured by such rejection" is "deemed to be a creditor" [Bankruptcy Act § 77B(b)(10)] closely resembles the language employed by Section 23 of the English Bankruptcy Act of 1869 (32 and 33 Vict., c. 71). After providing for the "disclaimer" of leases, that Act stated (Sec. 23):

> "Any person injured by the operation of this section shall be deemed a creditor of the bankrupt to the extent of such injury, and may accordingly prove the same as a debt under the bankruptcy."

Prior to the enactment of this provision, claims for the injury sustained by a landlord because of a rejection of his lease in bankruptcy proceedings, where the lease contained no covenant for damages or indemnity, were not provable. This language in the English Bankruptcy Act of 1869 served to make such claims provable.

> "In England such claims were not provable under the Act of 7 Geo. I, c. 31; *Mayor* v. *Steward*, 4 Burr. 2439; and a discharge could not be pleaded in defense of an action for rent accruing subsequent to bankruptcy. *Boot* v. *Wilson*, 8 East 311. The landlord's claim for loss of future rent was made provable by the Act of 32 and 33 Vict., c. 71, § 23 (1869), and

more explicit provisions to the same effect were embodied in that of 46 and 47 Vict., c. 52, §§ 37 and 55 (1883)."

Manhattan Properties v. *Irving Trust Co.*, 291 U. S. 320, 332.

Substantially the same language as was used in the English Bankruptcy Act of 1869 was repeated in the English Bankruptcy Act of 1883 (46 and 47 Vict., c. 52, Sec. 55). Again, the similarity to Section 77B is apparent:

"(7) Any person injured by the operation of a disclaimer under this section shall be deemed to be a creditor of the bankrupt to the extent of the injury, and may accordingly prove the same as a debt under the bankruptcy."

The law as fixed by the foregoing section has been stated by an English authority to be as follows:

"8. *Proof for injury done by the disclaimer.*—By sub-section (7) of Section 55 any person injured by the operation of a disclaimer is to be deemed to be a creditor of the bankrupt to the extent of the injury, and may accordingly prove the same as a debt under the bankruptcy. The measure of the damages, so far as the rent is concerned, will be the difference between the rent due under the lease for the residue of the term and the rent now to be obtained (*Re. Llynvi Coal Co.*, 7 Ch. 28), and it will include also the sum required to leave the property in the same state as if the covenants had been properly performed."

Disclaimer of Leasehold Property in Bankruptcy, 42 Solicitors' Journal 228, 230 (1898)

Subsequent English Bankruptcy Acts have employed the language quoted from the Act of 1883.

The present language of Section 77B which resembles the language in the English statutes was inserted at a

joint Congressional Conference held shortly before the enactment of the Bill.

It is significant to note that this change in Section 77B was made in May, 1934, a few months after February, 1934, when this Court, in the *Manhattan Properties* opinion, called attention to the fact that the language in the English Bankruptcy Acts of 1869 and 1883 had made landlords' claims for loss of future rents provable.

The similarity of the language in Section 77B (except for the limitation in the amount of the claim) to the language used in the English Bankruptcy Acts makes it apparent that it was utilized with the deliberate intention of accomplishing the results which had been successfully obtained in England.

POINT III

Section 77B eliminates the distinction between the provability of claims under leases and claims under other executory contracts.

The injustices which existed in the relationship between a landlord and his bankrupt tenant prior to the enactment of Section 77B of the Bankruptcy Act (and the amendment of Section 63(a) of the Bankruptcy Act) in June, 1934, resulted from the refusal of the courts to give the same provable claim for the breach of an executory lease contract as was given for the breach of other executory contracts.

The inequitable situation created by this discrimination has already been indicated. Creditors having claims for injury resulting from the rejection of executory contracts other than leases were given the right to participate, for the injury resulting from the abrogation of their contracts, in the division of the bankrupt's assets. But a landlord whose executory lease contract had been rejected in bankruptcy proceedings had no provable claim

for the injury which he had sustained. It is true that he could keep the lease alive, in spite of the fact that it was not being performed, and could hold the bankrupt (shorn of all its assets) for the performance of the lease, but this was a "paper" right which had no value, since the bankrupt was deprived of all power to perform the lease.

It is not surprising that in 1934 Congress determined to correct this situation by extending to landlords the same right to prove claims as existed under other executory contracts.

Section 77B clearly indicates an intent to include leases among executory contracts and to give parties to executory contracts (including leases) equivalent rights. Except for the limitation upon the amount for which a claim may be proved, the provisions in Section 77B regarding executory contracts and unexpired leases are identical.

Clause (6) of subdivision (b) provides that a plan of reorganization "may reject contracts of the debtor which are executory in whole or in part, including unexpired leases [ ] [ ]".

Clause (10) of subdivision (b) defines "creditors" as including holders of claims under executory contracts "whether or not such claims would otherwise constitute provable claims" under the Bankruptcy Act. It also provides that a person injured by the rejection of "an executory contract or unexpired lease" shall have a provable claim.

Clause (5) of subdivision (c), which gives the judge in reorganization proceedings power to "direct the rejection of contracts of the debtor executory in whole or in part", without expressly referring to leases, clearly includes leases among "contracts". Unless leases are included among "contracts executory in whole or in part", no power is given to a judge to reject a lease, although subdivision (b) (10) gives a provable claim when an "executory contract or unexpired lease" has been "rejected pursuant to direction of the judge".

The *Amici Curiae* respectfully urge that this identical treatment of claims under leases and claims under other executory contracts was designed to eliminate the confusion which the courts had formerly drawn between such claims. The result is that the doctrine of *Central Trust Co. v. Chicago Auditorium* [240 U. S. 581] is now applicable to leases of real estate as well as to other executory contracts.

The fundamental principles which guided this Court when it decided the *Chicago Auditorium* case are expressed in the following quotations:

> "Coming to the merits: It is no longer open to question in this court that, as a rule, where a party bound by an executory contract repudiates his obligations or disables himself from performing them before the time for performance, the promisee has the option to treat the contract as ended, so far as further performance is concerned, and maintain an action at once for the damages occasioned by such anticipatory breach (p. 578).
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> "* * * There is no doubt that the same rule must be applied where a similar repudiation or disablement occurs during performance (p. 580).
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> "* * * The immediate effect of bankruptcy was to strip the company of its assets, and thus disable it from performing (p. 580).
>
> "* * * the same principle that entitles the promisee to continued willingness entitles him to continued ability on the part of the promisor. In short, it must be deemed an implied term of every contract that the promisor will not permit himself, through insolvency or acts of bankruptcy, to be disabled from making performance; and, in this view, bankruptcy proceedings are but the natural and legal consequence of something done or omitted to be done by the bankrupt, in violation of his engagement. It is the purpose of the Bankruptcy Act, generally speaking, to permit all creditors to share in the distribution of the assets of the bankrupt, and to leave the honest debtor thereafter free from liability upon previous obligations. *Williams* v. *U. S. Fidelity Co.*, 236 U. S. 549, 554. Executory agreements play so

> important a part in the commercial world that it would lead to most unfortunate results if, by interpreting the Act in a narrow sense, persons entitled to performance of such agreements on the part of bankrupts were excluded from participation in bankrupt estates, while the bankrupts themselves, as a necessary corollary, were left still subject to action for non-performance in the future, although without the property or credit often necessary to enable them to perform. We conclude that proceedings, whether voluntary or involuntary, resulting in an adjudication of bankruptcy, are the equivalent of an anticipatory breach of an executory agreement, within the doctrine of *Roehm* v. *Horst*, *supra*." (pp. 591-2.)

Under Section 77B, as under the doctrine of the *Chicago Auditorium* case, the claim is given for the breach of an "implied term of every contract that the promisor will not permit himself, through insolvency or acts of bankruptcy, to be disabled from making performance . . ." (240 U. S. 581, 591). This breach occurs upon the initiation of the proceedings when the lessee or contractor permits itself to be deprived of the power of performing its obligations by surrender of all its assets to the bankruptcy court or its receiver or trustee.

After his appointment, the receiver or trustee has a reasonable period of time within which to adopt or assume the contract or lease.

If he assumes or adopts the contract or lease within such period and thereafter fully performs its terms and conditions, the court, as a court of equity, will disregard (in the absence of an express covenant to the contrary) the prior "equivalent of an anticipatory breach", and will not permit a forfeiture of the contract or lease. No "injury" has resulted to the contractor or landlord. The assets of the debtor in the possession of the court are now available for the satisfaction of claims arising under the contract or lease which was assumed or adopted by the receiver or trustee.

If the contract or lease is not assumed or adopted by the receiver or trustee, the full effect of "the equivalent of an anticipatory breach" remains unmitigated. The contractor or landlord is "injured". He cannot enforce his contract or lease against the assets of his debtor or lessee.

> "As we have seen in the Termination of Lease Proceeding, a receiver is entitled to a reasonable time in which to determine whether to adopt or renounce the contracts of the corporation for which he is appointed. During this trial period the operations under the contract may go on and the legal consequences flowing from the fact of the receivership may be suspended in their operation. If the receiver elect to adopt the contract, his adoption relates back to the beginning of the receivership and the contract continues as if nothing had taken place. That which would otherwise have amounted to a breach of the contract does not have that effect on account of the receiver's acceptance of it. On the other hand, it necessarily follows that when a receiver rejects a contract, his rejection relates back to the beginning of the receivership and the breach of the contract takes place as of that time."
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> *Pennsylvania Steel Co.* v. *New York City Ry. Co.*, 198 Fed. 721, 744.

Every failure of the receiver or trustee to assume or adopt a contract or lease is a "rejection". No other sensible meaning can be given to this term as used in Section 77B. Any attempt to distinguish a mere failure to assume or adopt from an affirmative act of "rejection" would make it possible for the receiver or trustee to withhold a claim under Section 77B by inaction or to grant a claim by affirmative rejection. This, obviously, would be highly objectionable.

This view is in accord with the view of this Court in the *Chicago Auditorium* case. In that case there was no affirmative act of rejection. There was merely a failure to assume or adopt the contract.

The *rejection* is not a *breach* of the contract or lease. The receiver or trustee is under no obligation to assume or adopt the contract or lease. His failure to do so ("rejection") is therefore not a breach.

The breach antedates the "rejection" (failure of the receiver or trustee to assume), and occurs when the lessee or contractor permits itself to be deprived of the power of performing its obligations by surrender of all its assets to the bankruptcy court and its receiver or trustee. This breach occurs upon the initiation of the proceedings and not when the receiver or trustee fails to assume or adopt the contract or lease.

Under Section 77B the claim is not given for a *breach* of the lease caused by its rejection, but for the "injury resulting from the rejection". As an assumption or adoption of the lease by the receiver or trustee results in its performance, the "injury resulting from the rejection" (failure to assume or adopt) is measured by the value to the landlord of performance of the lease.

Except for a limitation in the total amount which may be proved, Section 77B measures the claim for a rejection of a lease just as in the case of any other executory contract. In the absence of an express provision in the contract, it liquidates the claim by discounting future rent payments due under the contract and subtracting the appraised value of the use of the premises for the balance of the term. If the lease has a covenant for damages or indemnity—if the parties have expressly agreed upon the measure of the claim—and the measure is not too speculative to admit of reasonable proof and is not in the nature of a penalty, the claim is measured by the terms of the covenant for damages or indemnity. If the covenant for damages or indemnity is in the nature of a penalty or is too speculative to admit of reasonable proof, the covenant must be disregarded and the claim measured as though the lease contained no covenant for damages or indemnity.

Until the landlord is given the right to possession of the premises by "surrender" by the receiver or trustee, or until the landlord takes possession through "reentry", he is entitled to all accrued and unpaid rent; thereafter (since he has possession of the premises or may take such possession) he is entitled to prove a claim only for the difference between the reasonable value of the use of the premises and the rent reserved in the lease, limited however to a sum amounting to not more than three years of rent.

The doctrine of the *Chicago Auditorium* case operated to give complete and equitable relief to parties to ordinary executory contracts. The extension of this doctrine operates to give similar relief to the parties to an executory lease of real estate. The tenant is relieved of future obligations under the lease. The landlord is given a provable claim against the estate of his tenant.

By interpreting the rent claim provisions of Section 77B as extending the doctrine of the *Chicago Auditorium* case to leases, an equitable and logical solution of all problems dealing with claims under leases may be had. Any other interpretation of the language of Section 77B results in inconsistencies and confusion. This is illustrated by the difficulties experienced by the Court below in passing upon a landlord's claim under a lease containing a covenant of indemnity (See discussion of *Kuhner* case, *infra*, pp. 22-4).

POINT IV

The decision of the Court below on the Kuhner claim [*Kuhner* v. *Irving Trust Co.*, 85 F. (2d) 35] is contradictory to its decision on the claim in this case.

In the *Kuhner* case, as in this case, the trustee in the prior bankruptcy proceeding rejected the lease. In each case the landlord reentered after such rejection. In the *Kuhner* case the lease contained a covenant of indemnity under which it was agreed that if the lessee should be adjudicated a bankrupt the landlord might reenter and the lessee would then "indemnify the Landlords against all loss of rent which the Landlords may incur by reason of such termination during the residue of the term" [85 F. (2d) 35, at 36]. In the case at bar the lease contained no such covenant. The Circuit Court of Appeals allowed the claim in the *Kuhner* case but denied the claim in the case at bar.

In the *Kuhner* case, the Court correctly held that an absolute liability of the lessee on the covenant of indemnity was created by the bankruptcy of the lessee and the reentry of the landlord, and that such liability still existed when the proceedings under Section 77B were initiated. However, instead of allowing a claim on the liability created by this covenant, the Court allowed the claim as for an injury resulting from the rejection of the lease in bankruptcy.

In the *Kuhner* case the landlord had no "claim against a lessee for damages or indemnity under a covenant contained in a lease which would have been recoverable in a civil action had there been no 77B petition approved * * *" (which was the test applied by the Court in *In re United Cigar Stores Co. of America* (*Otis*), 83 F. (2d) 202, 206, and in this case).

The amount of the claim on the Kuhner covenant of indemnity was too speculative to be proved or recovered under applicable state law until the end of the original term of the lease (*Hermitage Co.* v. *Levine,* 248 N. Y. 333).

In addition, the claim actually allowed was different from, and contradictory to, the claim given to the landlord by the express language of the covenant. Under the covenant of indemnity, the claim was to be measured by the difference, at the end of the term of the lease, between the amounts of rent actually collected by the landlord during the term and the total rents to be paid under the lease. The Court permitted the claim "to be liquidated like a claim for breach of an executory contract for chattels; that is, by discounting the future payments and subtracting the appraised value of the term from their sum". [85 F. (2d) 35, at 37.]

In spite of its statement that "we cannot suppose that Congress was trying to make over the contract" [85 F. (2d) 35, at 37], the Court actually *did* make over the contract of indemnity by allowing a claim which was not based on such contract of indemnity. As this Court stated in *Manhattan Properties* v. *Irving Trust Co.,* 291 U. S. 320, at 337:

> "* * * These [indemnity covenants] do not provide for liquidation of damages (compare *Wm. Filene's Sons Co.* v. *Weed, supra*), nor indeed for any right to damages for breach of the covenant to pay rent."

The result reached by the Court in determining the Kuhner claim was sound. The claim was properly liquidated "like a claim for breach of an executory contract for chattels" [85 F. (2d) 35, at 37.] But this conclusion is warranted only on the theory that Section 77B gives the same provable claim on an executory lease as on any other executory contract; that the damages resulting from the breach of the covenant of indemnity in the

Kuhner lease were too speculative to admit of reasonable proof; and that the claim was therefore measured as though the lease contained no covenant for damages or indemnity.

On this theory, petitioner in the case at bar was entitled to the allowance of its claim.

POINT V

Surrender or reentry after the rejection of a lease does not deprive the landlord of his right to prove a claim. On the contrary, it is a condition precedent to proof of the injury resulting from the rejection.

Section 77B(b) (10) provides that the claim of a landlord resulting from the rejection of an unexpired lease shall be: (1) for all "unpaid rent accrued up to such *date of surrender or reentry*"; plus (2) "an amount not to exceed the rent, without acceleration, reserved by said lease for the three years next succeeding the *date of surrender* of the premises to the landlord or the *date of reentry* of the landlord, whichever first occurs, * * *." (Italics ours.)

No claim is provable until after there has been either a "surrender of the premises to the landlord" or a "reentry of the landlord".

Surrender or reentry by the landlord does *not* take away the remedy given by Section 77B. It is a condition precedent to the provability of the claim. Without a surrender or reentry there is no prescribed method for fixing the amount of the claim.

Even aside from the express provision in Section 77B, it is obvious that the landlord's claim may be measured only if the lease is terminated. An obligation to pay rent remains against the tenant so long as the lease is alive. While this liability exists, the amount of the landlord's

damage will be contingent upon the rent paid in the future by the tenant or his assignee. If this possibility of performance is not eliminated, the damage to the landlord will be too speculative to be proved. One of the grounds for not allowing rent claims in bankruptcy prior to the amendment of Section 63(a) of the Bankrupcty Act in 1934, was "because of the uncertainty at the date of adjudication that the lessor will reenter" (*Manhattan Properties* v. *Irving Trust Co.*, 291 U. S. 320, 331).

The original rent provision in the Bill which enacted Section 77B (H. R. 5884, 73rd Cong., 1st Sess., 77 Cong. Rec. 5009-5013, June 5, 1933) declared that a claim under a rejected executory contract would be allowed "provided such contract shall not have terminated by forfeiture, reentry, or otherwise." The omission of this language in the Act as passed must be taken as a clear indication of a change in the intent of Congress.

POINT VI

Section 77B grants the right to prove a claim where a lease was rejected and terminated prior to the enactment of Section 77B in a bankruptcy proceeding which was still pending when the proceedings under Section 77B were initiated.

Section 77B (b) (10) gives the landlord the right to prove a claim for the resultant injury "In case an * * * unexpired lease of real estate * * * shall have been rejected by a trustee or receiver in *bankruptcy* * * * *in a proceeding pending prior to the institution of a proceeding under this section* * * *." It also provides that the limitation of the landlord's claim shall be measured from "the date of surrender of the premises to the landlord or the date of reentry of the landlord, * * * *whether before or after the filing of the petition* * * *" (Italics ours.).

This language is clear. No argument seems necessary to establish the intent of Congress to bestow upon the landlord a claim for injury caused by the rejection of his lease in a prior bankruptcy proceeding, even if the premises were surrendered to the landlord, or he reentered, "*before* * * * the filing of the petition * * *" initiating the proceedings under Section 77B. (Italics ours.)

The provisions of Section 77B are applicable to debtors and creditors whose interests were acquired *prior* to the enactment of Section 77B and to proceedings in bankruptcy which were pending at the time of such enactment.

> "(p) This section shall take effect and be in force from and after the date of the approval of this amendatory Act, and *shall apply as fully to debtors,* their stockholders *and creditors, whose interests or debts have been acquired or incurred prior to such date,* as to debtors, their stockholders and creditors, whose interests or debts are acquired or incurred after such date. *Proceedings under this section may be taken in proceedings in bankruptcy which are pending on the effective date of this amendatory Act*" (Italics ours.).

Almost identical language was used in the enactment of Sections 74, 75 and 77 of the Bankruptcy Act in March, 1933:

> "* * * This Act shall take effect and be in force from and after the date of its approval, and shall apply as fully to debtors, their stockholders and creditors, whose interest or debts, whether secured or unsecured, have been acquired or incurred prior to such date, as to debtors, their stockholders and creditors, whose interest or debts have been acquired or incurred after such date. Proceedings under section 1 of this Act may be taken in proceedings in bankruptcy which are pending on the effective date of this Act."
>
> Sec. 2 of Public Law No. 420, 72d Cong., 2d Sess. (Mar. 3, 1933), Chap. 204, 47 Stat. 1467, at 1482.

Commenting on this language, the Circuit Court of Appeals for the Seventh Circuit said:

> "Considering the remedial character of the legislation and the comprehensiveness of the above-quoted words, we are left in little doubt as to its construction.
>
> "Certainly, Congress intended by this amendment to provide for the more effective and satisfactory administration of the estate of an insolvent debtor or of a debtor who, having property, was nevertheless unable to meet his obligations as they matured, than was possible under the act before it was amended. In view of the purpose, it was both natural and logical for Congress to make available the remedies which the new act provided, to those who had begun, and against whom there had been begun, bankruptcy proceedings before March 3, 1933, but whose estates were still being administered in the courts of bankruptcy. To limit the language to instances where involuntary petitions had been filed in bankruptcy but wherein no adjudication had occurred would not only largely nullify its effect but would be contrary to the wording of the above-quoted provision and violative of the purpose of the legislation."
>
> *Grzenia* v. *Lucius*, 66 F. (2d) 349, 350.

In the absence of language indicating a contrary intent, a statute containing a new procedure or providing a new remedy is deemed to apply to conditions existing at the time of its enactment.

> "Statutes regulating legal remedies are generally construed as operative upon an existing condition of things as well as upon conditions to arise after their enactment. 'Where a new statute deals with procedure only, *prima facie* it applies to all actions—those which have accrued or are pending and future actions.' (Sutherland on Statutory Construction, p. 630.)"
>
> *Laird* v. *Carton*, 196 N. Y. 169, 171.

A consideration of the conditions which existed at the time when Section 77B was enacted makes it manifest that

Congress intended to give relief to landlords who had been unjustly deprived of their rights by the rejection of leases in bankruptcy proceedings prior to the enactment of Section 77B.

The Debtor and other chain store corporations with numerous executory leases had voluntarily instituted bankruptcy proceedings in 1932. Although bankruptcy proceedings are usually intended for liquidation rather than reorganization, and these corporations desired reorganization, they went into bankruptcy because it afforded them an opportunity to avoid more lease claims than in an equity receivership.

The use of bankruptcy proceedings merely to cut off the claims of landlords was generally criticized, and almost became a national scandal. The facts were well known to the members of Congress. It was natural therefore for Congress to provide in Section 77B that a corporation desiring to discontinue pending bankruptcy proceedings and avail itself of the benefits of reorganization under Section 77B, could do so only if it granted the landlord a provable claim for the injury which he had previously sustained by the rejection of his lease in bankruptcy.

That the provision in Section 77B relating to a rejection of an unexpired lease in a prior proceeding was included with specific reference to rejections which had occurred prior to the enactment of Section 77B becomes further apparent when it is realized that in the future the spectacle of a corporation first being subjected to bankruptcy proceedings and then having its administration transferred to proceedings under Section 77B is bound to be rare. The more likely procedure will be to attempt rehabilitation of the corporation under Section 77B first and to resort to liquidation only when the futility of reorganization becomes evident. It seems therefore that corporations which were in bankruptcy when Section 77B was enacted were the particular debtors against whom these rent provisions were directed.

The amendment of Section 63(a) of the Bankruptcy Act, in June, 1934, also serves to reveal the intent of Congress to afford new remedies to persons interested in proceedings instituted before the amendments were enacted. The first amendment [48 Stat. 923, 924], adopted on the same day as Section 77B, made the new rent provisions of Section 63(a) applicable to "estates pending at the time of the enactment of this amendatory Act". Shortly thereafter, a further amendment [48 Stat. 991] made the rent provisions of the amended Section 63(a) applicable only to pending estates in which the time for filing claims had not expired. The original amendment was obviously intended to apply to claimants in *all* proceedings pending at the time of its adoption, for otherwise the subsequent amendment would have been unnecessary.

The limitation imposed by the second amendment of Section 63(a) was desirable in bankruptcy proceedings because of the confusion which would result if pending estates were required to reopen their proceedings after the time to file claims had expired. A similar limitation was not inserted in Section 77B. It was not required. No proceedings under Section 77B were, of course, then pending.

POINT VII

The grant of the right to prove a claim for the injury caused by the rejection of a lease in a bankruptcy proceeding pending when Section 77B was enacted is not unconstitutional.

This Court has already stated that Congress may grant a provable claim for future rents under a lease which has no covenant for damages or indemnity.

> "The issue is not one of power, for plainly Congress may permit such claims or exclude them. * * *"
>
> *Manhattan Properties* v. *Irving Trust Co.*, 291 U. S. 320, 332.

No constitutional rights of a debtor, or of any of its creditors or stockholders, are invaded by granting a landlord a right to prove a claim for the damages sustained by him as a result of a rejection of his lease *before* the enactment of Section 77B in bankruptcy proceedings which were pending when Section 77B was enacted and which are subsequently merged into the 77B proceedings.

Creditors who extended credit after the filing of the petition in bankruptcy enjoy the priority which attaches to all expenses of administration and will therefore be paid in full before any distribution is made to the landlord. Such creditors can not be injured by the allowance of the landlord's claim.

The creditors with whom the landlord is permitted to participate on a parity in the distribution of the debtor's assets under Section 77B extended credit before the filing of the petition in bankruptcy and therefore at a time when the landlord's lease was a valid and subsisting obligation of the debtor. Such creditors can not claim that assurances upon which they relied in extending credit have been defeated. As the Court said in *In re Inland Dredging Corp.*, 61 F. (2d) 765, 766, "All that was done was to provide for a new division of any pot, which should in the future arise through the sequestration of the debtor's assets in bankruptcy, or any other insolvency proceedings".

With knowledge of the plight of this Debtor and of some of the other large chain store corporations which had utilized bankruptcy proceedings to cut off rent claims without intending to liquidate their enterprises in the manner prescribed by the Bankruptcy Act, Congress deliberately extended relief to such corporations by affording them a new vehicle for reorganization. But as a condition to use of the new procedure by corporations *already in bankruptcy*, Congress provided that landlords injured by the rejection of leases in the bankruptcy proceedings must be permitted to prove claims for the injury which resulted from such rejections.

Although this Debtor *voluntarily* initiated the proceedings under Section 77B, it now proposes to accept the benefits of the new procedure without submitting to its burdens. It desires to utilize the new procedure without complying with the conditions which Congress imposed upon the acceptance of the benefits.

The Debtor had no constitutional right to the use of Section 77B. Congress could have provided that the new procedure be available only to corporations not already in bankruptcy. When it conditioned the use of this procedure upon a recognition of landlords' claims for injuries inflicted in the bankruptcy proceedings, Congress was therefore well within its constitutional power.

Having voluntarily accepted the benefits of Section 77B, the Debtor is estopped from denying the validity of the conditions precedent to its acceptance of such benefits. Since it is already in proceedings under Section 77B, it is particularly estopped from denying the validity of conditions without the performance of which it is not entitled to be in such proceedings.

Section 77B regulates the distribution of the assets of a debtor in the possession of the bankruptcy court. It does not redefine or change the substantive law of landlord and tenant.

The proceeding initiated by this Debtor under Section 77B is merely a continuance of the prior bankruptcy proceeding in which the petition initiating the 77B proceeding was filed and in which this landlord's lease was rejected. The proceeding under Section 77B is "an amplification or new end product of the original bankruptcy, just as though the bankrupt or the alleged bankrupt had proposed a composition, * * *" (*In re Paramount Publix Corp.*, 85 F. (2d) 42, 44).

> "* * * The bankruptcy proceeding is indeed truncated midway and not allowed to conclude as it began; but the graft does not make it a new growth from the root, and the result is certainly meant to be an organic whole."
>
> *In re Paramount Publix Corp.*, 85 F. (2d) 42, 45.

Before the petition in bankruptcy was filed, the landlord had the same right as other creditors to look to the assets then owned by the Debtor for the satisfaction of his claim. It was the bankruptcy proceedings, combined with the bankruptcy trustee's failure to assume or adopt the lease, which took away the landlord's right to look to the bankrupt's assets as of the filing of the petition for the satisfaction of his claim.

All that the landlord requests, and all that Section 77B gives, is the right, as a creditor of the Debtor at the time the petition in bankruptcy was filed, to participate equitably with other creditors, having claims at that time, in the distribution of the assets which belonged to the Debtor on that date. To give effect to the intent of Congress and permit the landlord to participate in the distribution of the assets does not involve the recognition of a new claim not previously existing; it involves merely the recognition of a new remedy for the deprivation of the landlord's rights as they existed when the petition in bankruptcy was filed. By failing to adopt the lease, the trustee effectively divested the landlord of his remedy against the Debtor's assets. Congress has now given a new remedy for the injury resulting from the rejection of the lease and for the breaches which occurred both before and after the rejection.

Congress may, in the exercise of its power over the subject of bankruptcies, give a provable claim for an injury not previously recognized even though the incidental effect may be a reduction in the payments which would otherwise be made to other creditors.

Having power to regulate the currency, Congress may make paper money legal tender, even though a loss results to a creditor who must now accept a depreciated medium in satisfaction of his claim. *Legal Tender Case,* 110 U. S. 421. Under the same power, Congress may commandeer

metal or may cut down the rights of individual ownership in metal. *Ling Su Fan* v. *United States,* 218 U. S. 302. A valid claim to gold created by express provision of contract may be destroyed. *Norman* v. *B. & O. R. Co.,* 294 U. S. 240, 307, 308. By its power over interstate carriers, Congress may prohibit free transportation even though its mandate results in depriving an individual of a vested right to such transportation. *Louisville & Nashville R. R. Co.* v. *Mottley,* 219 U. S. 467, 482. In the interests of interstate commerce, Congress may direct an increase in intrastate rates which will nullify a right to lower rates acquired by the people of a state through express contract. *New York* v. *United States,* 257 U. S. 591.

So it is with the bankruptcy power. It was created so that Congress might have jurisdiction over the affairs of an impecunious debtor in the interests of an orderly and equitable readjustment. The power existing, its use can not be made to depend upon reasonable incidental effects.

When a creditor first acquires his claim, he obtains no right in the bankruptcy remedy then existing which is absolute and certain to remain fixed. His right is subject to the power over bankruptcies and it must yield to an exercise of this power. Congress may enact new and different relief for insolvent debtors and their creditors.

> "There was no vested right in the bankrupt to have the law stand as it was. No one would seriously question the right of Congress to modify the law, and state the conditions upon which debtors in the future could be discharged from their indebtedness, and, when the bankrupt made his application for a discharge in this proceeding, he invoked the law as it then was; and, under the statute of 1903, as we view it, the fact that he had been previously discharged from his indebtedness in a voluntary proceeding within six years was a statutory ground for withholding a second discharge upon his own application in this subsequent involuntary proceeding."
>
> *In re Seaholm,* 136 Fed. 144, 147.

The cases declaring that a *state* may not grant additional exemptions to debtors after creditors have extended credit and thereby deprive the creditors of their right, in state court proceedings, to look to such assets for the satisfaction of their claims, are not applicable. None of the cases decided on this point by this Court involved the exercise by Congress of its constitutional power over the "subject of bankruptcies". See *Edwards* v. *Kearzey*, 96 U. S. 595; *Bank of Minden* v. *Clement*, 256 U. S. 126.

Nor is the power of Congress in the exercise of its jurisdiction over the subject of bankruptcies involved in the cases dealing with the power of a state legislature over vested contract and property rights. See *Pritchard* v. *Norton*, 106 U. S. 124, 132; *Ballantine* v. *Macken* (N. J. Ct. of Err. & App.), 110 Atl. 910; *People* v. *Prather*, 343 Ill. 443, 175 N. E. 658; *State* v. *Shelton*, 138 Tenn. 345, 197 S. W. 1096; also 12 C. J. 973.

In Section 64 of the Bankruptcy Act [30 Stat. 563 (1898), as am'd, 32 Stat. 800 (1903), as am'd, 34 Stat. 267 (1906), as am'd, 44 Stat. 666 (1926), 11 U. S. C. A. § 104], Congress has provided certain priorities in the distribution of bankrupt estates. As a result, creditors who otherwise would share equally are relegated to a subordinate position. They are thus deprived of substantial rights originally possessed by them. But since the deprivation is incidental to an exercise of the power over bankrupt estates, there has been no violation of the Fifth Amendment. See *United States* v. *Fisher*, 6 U. S. (2 Cranch) 358.

Priorities given under an existing bankruptcy statute may be changed by a subsequent statute, and such a change is effective even as to claims arising prior to the change. *In re Inland Dredging Corp.*, 61 F. (2d) 765; *City of Chelsea* v. *Dolan*, 24 F. (2d) 522.

> "We cannot doubt the power. The act is remedial—to be liberally construed. Chelsea, on this record, had

no lien upon or vested right in the estate for its taxes; it had nothing but a claim under the Bankruptcy Act. It grounds its contention on this act, not on a lien under the statutes of Massachusetts. Congress has plenary power to pass uniform bankruptcy acts. 7 C. J. 18, and cases cited. It may amend or repeal at pleasure, provided it does not disregard the requirement of uniformity."

City of Chelsea v. *Dolan*, 24 F. (2d) 522, 523.

In the *City of Chelsea* case, *supra*, the court held the change applicable even though it became effective after the filing of the bankruptcy petition. In the *Inland Dredging Corp.* case, *supra*, the statute became effective before the filing of the petition in bankruptcy although after the debt was incurred.

Under its power over the subject of bankruptcies, therefore, Congress may change the order of priority in the payment of claims in bankruptcy proceedings, even after the claims have come into existence, thereby, in many instances, insuring payment in full to some classes of creditors while other classes receive nothing, in spite of the fact that the claims of both classes had equal priority under the state law and under the bankruptcy law at the time the claims arose.

It seems equally clear that Congress may permit a landlord, who had a valid and subsisting contract with the Debtor when the court took custody of its assets, to participate with other creditors in the division of such assets for the injury sustained by him through the deprivation of his right to look to the Debtor's assets for the satisfaction of his claims under the lease.

If the rights and remedies of all of the parties are actually fixed and crystallized by the bankruptcy proceeding, and such rights and remedies are only those which existed immediately prior to the filing of the petition under

Section 77B, then the use of proceedings under Section 77B by this Debtor is improper and illegal, and any creditor may insist on his right to have the assets of the Debtor liquidated as in bankruptcy in order that he may obtain the cash dividend which he would receive if the bankruptcy proceedings were consummated.

POINT VIII

The interpretation of the Court below makes redundant and of no effect the provisions in Section 77B granting the landlord a claim for the rejection of his lease.

The theory of the Circuit Court of Appeals, that no claim is provable unless the lessor has a claim under applicable state law or under a covenant for damages or indemnity when the 77B proceedings are initiated, ignores the fundamental basis of the remedy given to the landlord by Section 77B. It erroneously fails to base the claim upon a *rejection* of the lease, or even upon the lease itself. It bases the claim upon a debt created under state law by a prior breach of the lease, or upon a new contract for damages or indemnity arising under a covenant in the lease upon its termination (*Manhattan Properties* v. *Irving Trust Co.*, 291 U. S. 320, 338).

All debts and contract claims which are valid and enforcible against the debtor when the petition under Section 77B is filed are provable in the proceedings. No additional language is required to make provable a claim upon a debt or contract for damages or indemnity merely because it arises out of the breach of a lease. If the interpretation of the Court below is correct, therefore, the express language granting a landlord a claim for the rejection of his lease is redundant and without effect.

The Court below said that the language in Section 77B which gives the landlord a claim for the injury sustained by the rejection of his lease was intended "to make some valid claims [recognized under applicable state law] *provable* in proceedings under Section 77B which were not before provable in bankruptcy". (Italics ours.) [Opinion below in this case, 83 F. (2d) 209, 211]. This portion of Section 77B is not needed to make such claims provable. Section 77B elsewhere makes existing claims "provable" regardless of whether they would have been provable in ordinary bankruptcy proceedings. Subdivision (b)(10) provides that the term "creditors" shall include "holders of claims of whatever character against the debtor or its property, including claims under executory contracts whether or not such claims would otherwise constitute provable claims under this Act". (Italics ours.)

It has been argued that a claim under a lease rejected in a prior proceeding is provable only if the lease survives until the initiation of the proceedings under Section 77B. If this were the case, the bankrupt's continuing obligation under the lease could only be terminated by a rejection of the lease in the proceedings under Section 77B. The landlord's claim in that event would arise under the provision of Section 77B which gives a claim for the injury resulting from a rejection in the proceedings under Section 77B. Section 77B(b)(10), however, grants landlords the right to prove a claim for the resulting injury not only when a lease "shall be rejected * * * in a proceeding instituted under this section", but also when a lease "shall have been rejected by a trustee * * * *in bankruptcy* * * * *in a proceeding pending prior to the institution of a proceeding under this section.*" (Italics ours.) The latter provision has no meaning and effect unless it is applied to a case in which the lease has been terminated after rejection in the bankruptcy proceeding and prior to the initiation of the proceedings under Section 77B.

If the interpretation of the lower Court is accepted, some interesting questions suggest themselves:

May the landlord under a lease containing no covenant for damages or indemnity preserve his rights, after a rejection of the lease, by refusing to reenter or accept surrender of the premises? If so, what happens to the premises which have been abandoned by the trustee in bankruptcy and which the landlord, in order to preserve his claim, refuses to reenter? May the landlord keep the lease alive as an obligation of the debtor, and thereby prevent an effective reorganization?

Is a landlord deprived of all future rights under the rejected lease as well as all rights to damages in the proceedings, even if he refuses to reenter and repossess himself of the premises?

May Congress, under the Constitution, deprive the landlord of all rights under his lease, without compensation, if the benefits of such deprivation are given to the tenant (through its stockholders)?

It is respectfully submitted that the purposes of the reorganization proceedings may be accomplished and justice done to both landlord and tenant only if Section 77B is interpreted as granting (in the absence of an express covenant) the same provable claim to a landlord whose lease has been rejected as is given to a party whose executory contract has been rejected.

JOHN GERDES,
JOHN GODFREY SAXE,
Amici Curiae.

November 17, 1936.

SUPREME COURT OF THE UNITED STATES.

No. 260.—October Term, 1936.

City Bank Farmers Trust Company, Assignee, Petitioner, *vs.* Irving Trust Company, Trustee of the Estate of the United Cigar Stores Company of America, et al. } On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[January 4, 1937.]

Mr. Justice Roberts delivered the opinion of the Court.

Certiorari was granted in this and three following cases involving the construction and validity of provisions of Section 77B of the Bankruptcy Act[1] which enlarge the category of provable claims to include one by a landlord for injury due to rejection of a lease, or for damages or indemnity under a lessee's covenant.

Florence H. Bugbee, the petitioner's assignor, leased to United Cigar Stores Company of America premises in Trenton, New Jersey, for a term commencing April 1, 1926, and ending March 31, 1946. August 29, 1932, the lessee was adjudicated a bankrupt upon its own petition. November 11, 1932, the respondent, as trustee in bankruptcy, rejected the lease and abandoned the premises, a portion of which had been sublet by the bankrupt. Without notice to the Cigar Stores Company the landlord relet portions of the building to subtenants in possession and let other portions to new tenants.

June 9, 1934, two days after the passage and effective date of Section 77 B, the Cigar Stores Company, as permitted by subsection (*p*), filed in the pending bankruptcy proceeding its petition for reorganization. In the latter cause the petitioner presented a proof of claim for injury resulting from the rejection of the lease. The trustee objected to the claim and asked to have it expunged for the reason that the lease incorporated no covenant to indemnify the lessor for loss of rents or other provision enabling her to hold the tenant for damages or for rent accruing subsequent to termina-

[1] Added to the Bankruptcy Act of 1898 by Act of June 7, 1934, c. 424, § 1, 48 Stat. 912, as amended by Act of Aug. 20, 1935, c. 577, 49 Stat. 664, and Act of Aug. 29, 1935, c. 809, 49 Stat. 965; 11 U. S. C. 207.

tion of the leasehold estate, and asserted the leasehold had been terminated and all obligations of the debtor under the lease extinguished by the landlord's reentry and releting.

The special master who heard the cause recommended disallowance of the claim in the view that Section 77 B did not, and could not, create any valid and legal claims against the debtor where none existed anterior to the enactment of the section, and held that none existed before its adoption because, by the law of New Jersey, the landlord's reentry and releting worked a surrender of the leasehold. In his report the master referred to the fact that the record in the earlier bankruptcy proceeding disclosed a claim filed by the landlord, upon which dividends had been paid, for expenditures in restoring a party wall and closing up a common entrance in the leased building based upon the debtor's agreement to restore it at the expiration of the term, which was again asserted in the present proceeding. He thus commented upon this situation:

"Naturally, the entire basis of this claim for restoration is the expiration of the lease. The Trustee may well point to it, as showing that the Landlord, prior to the enactment of Section 77-B, by her re-entry and releting of the premises as aforesaid, considered that the lease terminated and expired."

The District Court approved the master's report and rejected the claim; and the Circuit Court of Appeals affirmed,[2] holding that the injury specified in Section 77B (b) (10) for which a claim by a landlord is allowable can only be such injury as would found an action under applicable state law. The court concluded that although according to the law of New Jersey the reentry and releting did not effect a surrender, the restoration of the building was such an assertion of dominion by the landlord as to deprive her of any further claim against the tenant.

The parties differ with respect to the correctness of the Circuit Court of Appeals' interpretation of the law of New Jersey. They also disagree as to whether the record supports the finding that the landlord restored a portion of the leased building. The disputes need not be resolved if the petitioner is right in asserting that, within the purview of Section 77 B, the lessor was a person injured by the rejection of the lease who is accorded a provable claim against the debtor's estate for the injury, notwithstanding the reentry, releting, and restoration of the premises, after rejection of the lease,

[2] 83 F. (2d) 209.

consummated a surrender of the leasehold, and ended the tenant's liability under the local law. As Section 77 B supplements and extends the bankruptcy system in force at the time of its enactment, we shall examine the question in the light of the old law, the supposed mischief arising under it and the alterations made by the later act.

1. Section 63 (a) of the Bankruptcy Act of 1898 [3] stated what claims should be provable in bankruptcy. The section gave a landlord no provable claim for rent to accrue after the trustee's rejection of a lease. The tenant's liability for future rent was not discharged and remained enforceable as instalments of rent fell due. This was necessarily so, since future rent is demandable only in the amounts and at the times named in the lease and the total cannot be recovered at law in a lump sum in advance of accrual of the instalments. This state of the law involved elements of hardship to both lessor and lessee. In the case of a corporate, and often in that of an individual lessee, the landlord's right to collect rent from a bankrupt tenant was valueless. On the other hand, if the landlord, notwithstanding rejection by the trustee, was compelled by its terms, or elected pursuant to its provisions, to treat the lease as still in force, he might throughout the remainder of the term harass the discharged bankrupt by successive actions for accruing rent and so retard or prevent the debtor's financial rehabilitation which the statute was intended to aid.

Many leases provide for the termination of the tenant's estate upon his adjudication as a bankrupt, by the lessor's reentry. Under the old law such termination did not give rise to a provable claim for future rent, or for damages, or for indemnity. Not uncommonly lease agreements, in addition to stipulation for termination of the leasehold upon the tenant's bankruptcy, provide that the bankrupt shall indemnify the landlord for loss of future rent. These provisions vary in their terms, some requiring the rendition of indemnity as each instalment of rent falls due, others at the end of the term when the full difference between the rent reserved and that received upon reletting can be ascertained. Under Section 63 (a) of the Act of 1898 such covenants did not support a provable claim, as the obligation to indemnify ripened after adjudication. The consequence was that liability under this sort of covenant was not discharged and remained to haunt the bankrupt.

[3] 30 Stat. 562.

As early as 1932 proposals were brought forward in Congress for the broadening of the bankruptcy system to authorize proceedings for the reorganization of business corporations. Bills authorizing proceedings in courts of bankruptcy to that end failed of passage in the 72d and 73d Congress. H. R. 5884, 73d Congress, Second Session, which ultimately became law as Section 77 B of the Bankruptcy Act was under consideration when the decision in *Manhattan Properties, Inc.* v. *Irving Trust Company,* 291 U. S. 320, threw into high relief the plight in which landlords found themselves as a result of the flood of corporate bankruptcies brought about by the economic depression. The situation of owners of business properties leased to chain store organizations which had resorted to voluntary bankruptcy largely as a lever to force revision of leases was the subject of comment in and out of Congress. By the same act Section 63 (a) was amended to give a provable claim to a landlord whose lease had been rejected by a trustee in bankruptcy and a similar provision was incorporated in 77 B, the new reorganization section. This history cannot be ignored in construing the supplemental legislation.

2. The purpose of Section 77B was to facilitate rehabilitation of embarrassed corporations by a scaling or rearrangement of their obligations and shareholders' interests, thus avoiding a winding up, a sale of assets, and a distribution of the proceeds. A salient element in such a reorganization is the discharge of all demands of whatsoever sort, executory and contingent, presently due or to mature in the future. Of such claims not the least important are those for rent to accrue under a lease, or for damages or indemnity payable because of the termination of a leasehold. Obviously if such obligations are to be discharged they must be made provable, for they cannot be destroyed. How, then, did the Congress deal with them?

The pertinent provisions of Section 77B are copied in the margin.[4]

Clause 10 renders provable claims upon covenants of indemnity maturing upon reentry after adjudication. The term "creditors"

[4] "(*a*) Any corporation which could become a bankrupt under section 4 of this Act, . . . may file an original petition, . . . in any proceeding pending in bankruptcy, whether filed before or after this section becomes effective. . . ."

"(*b*). . . . (10). . . . The term 'creditors' shall include for all purposes of this section and of the reorganization plan, its acceptance and confirmation, all holders of claims of whatever character against the debtor or its

is made to include "holders of *claims* of whatever character against the debtor or its property, including claims under executory contracts, *whether or not such claims would otherwise constitute provable claims under this Act.*" Bankruptcy of the obligor is an anticipatory breach of an executory contract and a claim for damages for the breach was provable under § 63 (a) of the Act of 1898.[5] One having a demand against a debtor whose affairs are in the hands of an equity receiver, if the claim matured after the receiver's appointment but before the expiration of the period fixed for presentation of claims, is entitled to prove and to share in distribution;[6] but the rule in bankruptcy has been that the claim under an executory contract must mature at or before the filing of the petition.[7] The language which is italicized in the foregoing quotation from clause 10 can have no other meaning than that claims upon covenants for damages or indemnity arising out of the termination of a lease after initiation of proceedings under Section 77B are provable. The provision, however, creates no new claim. It merely treats the adjudication as a breach of covenant and gives a provable claim in virtue of the breach.

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property, including claims under executory contracts, whether or not such claims would otherwise constitute provable claims under this Act. The term 'claims' includes debts, securities, other than stock, liens, or other interests of whatever character. . . .

"In case an executory contract or unexpired lease of real estate shall be rejected pursuant to direction of the judge given in a proceeding instituted under this section, or shall have been rejected by a trustee or receiver in bankruptcy or receiver in equity, in a proceeding pending prior to the institution of a proceeding under this section any person injured by such rejection shall, for all purposes of this section and of the reorganization plan, its acceptance and confirmation, be deemed to be a creditor. The claim of a landlord for injury resulting from the rejection of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease shall be treated as a claim ranking on a parity with debts which would be provable under section 63 (a) of this Act, but shall be limited to an amount not to exceed the rent, without acceleration, reserved by said lease for the three years next succeeding the date of surrender of the premises to the landlord or the date of reentry of the landlord, whichever first occurs, whether before or after the filing of the petition, plus unpaid rent accrued up to such date of surrender or reentry: . . ."

"(*p*) This section shall take effect and be in force from and after the date of the approval of this amendatory Act and shall apply as fully to debtors, their stockholders and creditors, whose interests or debts have been acquired or incurred prior to such date, as to debtors, their stockholders and creditors, whose interests or debts are acquired or incurred after such date. Proceedings under this section may be taken in proceedings in bankruptcy which are pending on the effective date of this amendatory Act."

[5] *Chicago Auditorium Association* v. *Central Trust Company*, 240 U. S. 581.

[6] *Wm. Filene's Sons Co.* v. *Weed*, 245 U. S. 597, 601-602.

[7] *Manhattan Properties, Inc.* v. *Irving Trust Company, supra.*

Since in the instant case the lease contains no such covenant, in the absence of some further provision respecting landlords' claims the petitioner would be without remedy under Section 77B as it would have been in strict bankruptcy proceedings under Section 63 (a) of the Act of 1898 until that section was amended in 1934. There is, however, a further provision: "In case an executory contract or unexpired lease of real estate shall be rejected pursuant to direction of the judge [See subsection (c) (5).] given in a proceeding instituted under this section, or shall have been rejected by a trustee or receiver in bankruptcy or receiver in equity, in a proceeding pending prior to the institution of a proceeding under this section *any person injured* by such rejection shall, for all purposes of this section and of the reorganization plan, its acceptance and confirmation, be deemed to be a creditor." Under the old law the rejection of a lease by a trustee in bankruptcy was not a breach of the lease, in the absence of a specific agreement that it should be so. The bankrupt tenant remained liable for the rent as it fell due but all the assets wherewith he might pay were taken from him. For a default in payment subsequent to adjudication the landlord might reenter and terminate the lease. By virtue of a covenant so providing the landlord might treat the bankruptcy as cause for reentry and termination of the leasehold estate. While, therefore, the rejection of a lease by a trustee in bankruptcy might, and usually did, spell possible or probable injury to the landlord, that fact gave him no standing as a creditor in the bankruptcy proceeding. Having in mind this state of affairs the purpose is clearly to give a landlord a provable claim for injury due to the rejection of his lease, whether the instrument contains a covenant of indemnity or not.

Although, as we have noted, under the Act of 1898 rejection by the trustee was not a breach of the lease, it left the premises in the possession of an impecunious tenant with the virtual certainty they would be thrown back upon the landlord's hands untenanted. If the owner could not turn his property to account on terms as favorable as those embodied in the rejected lease obviously he suffered an injury.

The opinion in the *Manhattan Properties* case, *supra,* adverts to the fact that for many years the English bankruptcy acts have given a remedy for the loss of future rents due to supervening bankruptcy and sequent rejection of the lease.[8] Congress was familiar

[8] 291 U. S. at p. 332.

with this fact when Section 77B was under discussion.[9] The analogous provisions of the English Acts while differently phrased are of the same purport as those of Section 77B.[10] Congress intended to supply the omission of the Act of 1898 and to create a claim provable in a reorganization proceeding for injury due to a trustee's rejection. This conclusion finds further support in the succeeding sentence, which in limiting the amount allowable upon these claims, refers to them in three aspects, thus: "The claim of a landlord for injury resulting from the rejection of an unexpired lease of real estate *or* for damages *or* indemnity under a covenant contained in such lease", etc.

3. Like any other provable claim, that of a landlord for injury resulting from rejection of the lease, or for damages or indemnity for termination of the tenure, may, for an adequate consideration, be released, *Schwartz* v. *Irving Trust Company* (No. 436, post). The lease, moreover, may contain stipulations, fulfillment of which is to be full compensation for any loss due to termination of the leasehold and thus bar any claim under 77 B for the landlord's loss. *Meadows* v. *Irving Trust Company* (No. 151, post).

4. The question for decision in this case is whether the claim recognized by Section 77 B, which would not have been an enforceable demand at common law, or under the laws of many of the states, is allowable only if the leasehold estate has not, after rejection of the lease, been drowned by surrender effective under state law or otherwise terminated pursuant to state law by the lessor's conduct.

We think it clear that provability of such a claim is unaffected by any termination of the leasehold subsequent to rejection of the lease. The provision is that the landlord's claim for injury resulting from rejection, or for damages, or for indemnity under a covenant, shall be limited to an amount not exceeding the rent reserved "for the three years next succeeding *the date of surrender of the premises to the landlord or the date of reentry of the landlord, whichever first occurs*, whether before or after

[9] Cong. Rec., Vol. 76, Part 3, p. 2940.

[10] 32 & 33 Vict., c. 71, § 23 (1869); 46 & 47 Vict., c. 52, § 55 (1) (3) (7) (1883); 4 & 5 George V, c. 59, § 54 (1) (3) (7) (1914). The subject is first mentioned in the Act of 1869. The English acts authorize "disclaimers" of onerous property or contracts and specifically refer to leases. The provision for a provable claim based on a disclaimer is the same in the Acts of 1883 and 1914, "Any person injured by the operation of a disclaimer under this section shall be deemed to be a creditor of the bankrupt to the extent of the injury, and may accordingly prove the same as a debt under the bankruptcy."

the filing of the petition, ..." Plainly the word "reentry" is used to describe a case where the landlord, treating the bankruptcy as a breach of the lease, reenters for condition broken. Whether the other phrase, "surrender of the premises to the landlord", denotes the technical surrender which drowns the particular estate in the reversion, or the mere tradition to, and acceptance by, the landlord of possession, is immaterial. The amount of the landlord's claim for the loss of his lease necessarily is the difference between the rental value of the remainder of the term and the rent reserved, both discounted to present worth. This, we have said, is a method of liquidation familiar and fair. It was the method adopted under Section 77 B in *Kuehner* v. *Irving Trust Company, et al.*, 85 F. (2d) 35, the judgment in which is this day affirmed (No. 354, post). If the landlord must give credit for the present rental value of the premises he is entitled to avail himself of them for realization of that value, and this he cannot do without reentry and reletting. If he must give such credit he surely has the option to attempt recoupment of his loss by occupying the premises for the remainder of the term. But such occupation, under the law of most of the states, amounts to a complete termination of the leasehold and deprives the landlord of any further rights as lessor. It is evident that if a lease be rejected the subsequent repossession of the demised premises, and acts of control and dominion do not destroy the provability of a claim under Section 77B.

It is suggested that if a landlord desires to avail himself of the privilege accorded by the Section, he must keep the leasehold estate intact until his claim shall have been proved and allowed. In view, however, of the obvious intent of the statute to extend relief not only to landlords whose leases may in future be rejected, but also to those whose leases have been rejected in prior bankruptcy or equity proceedings, such a construction would ill accord with the remedial purposes of the act, which demand a liberal construction in favor of the claimants for whom relief was intended.

We conclude that the petitioner's claim should have been allowed. The judgment is reversed and the cause is remanded to the District Court for further proceedings in conformity with this opinion.

So ordered.

Mr. Justice BRANDEIS took no part in the consideration or decision of this case.